

July 7, 2006

Mr. Richard Krolak
Chief, CalPERS Office of Long Term Care
400 P Street, 5th floor
Sacramento, CA 95814

Subject: CalPERS LTC Program – Proposed Mitigation Initiatives –
For Discussion at July 18th Meeting

Dear Mr. Krolak:

The purpose of this document is to present additional data/information relating to the proposed mitigation initiatives presented and discussed at last month's Advisory Committee meeting.

Proposed Mitigation Plan – Background

In my previous letter regarding this issue, I proposed the following preliminary mitigation plan for review and discussion:

- That the minimum target funding level include a 10% margin at a 7.79% discount rate. Therefore, we should consider the projected funding deficit to be approximately 43%.
- That we implement a rate adjustment scenario that moves inforce rates to 2006 rate levels.
- That we account for new business scenario described in the section above that would reduce the projected deficit by approximately 3.8%.
- That we not make any explicit provision for the impact of plan migration at this time.
- That we account for the 2%-3% additional future morbidity improvement identified by LTCG staff.

Given 2005 valuation assumptions, implementing this plan would have essentially resulted in a projected surplus of between 15%-20% as of 6/30/05.

Proposed Mitigation Plan – Round #2

Based on feedback received during our June 6th meeting and subsequent discussions with CalPERS staff, we modified the preliminary mitigation plan as follows:

- We recalculated the minimum target funding level to include a 3% margin at a 7.79% discount rate. As a result, the projected funding deficit is approximately 32.2%.
- We accounted for two new business scenarios – the first assumes 2005 premium production for the next ten years, while the second assumes twice the 2005 premium production for the next ten years.
- We accounted for 2.5% of additional future morbidity improvement identified by LTCG staff.
- Given all of the above, we calculated aggregate rate adjustments that, when combined with the other mitigation actions, resulted in the target funding level.
- We then developed rate adjustment scenarios by plan using 2006 rate levels as caps, and assuming the following implementation scenarios:
 - A one-time increase implemented effective 5/1/07.
 - A two-step increase implemented effective 5/1/07 and 5/1/08.
 - A two-step increase implemented effective 5/1/07 and 5/1/09.
 - A five-step increase implemented annually effective 5/1/07 through 5/1/11.

Attachments 1 and 2 summarize all of the above. I will be prepared to discuss any proposed revision to this plan during our meeting.

For your information, the following items still need to be addressed:

- We have not benefit-adjusted the 2006 rate-level caps referenced above.
- We have not yet made any explicit provision for the impact of plan migration.
- We have not yet attempted to define how the proposed rate adjustment scenarios would work using 2003-like socialization.

We can address the last two items above after we have seen what scenarios continue to receive consideration given the results of our meeting.

Please note that, given the response(s) to the last letter and the data/information presented therein, I would prefer not to present hypothetical socialization scenarios unless we know what scenarios are realistically being considered.

Our analyses assume that administrative expenses are consistent with valuation assumptions. To the extent that they are not (e.g., administrative expenses increase significantly due to complicated mitigation scenarios), our analyses might need to be revised.

A Note Regarding Implementation

As indicated in my last letter, based on my experience, regardless of the mitigation plan agreed upon, we will not be able to identify or understand all of the issues involved with

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the plan until we begin to work through the implementation process. Given that, I would recommend that any decisions made by the Advisory Committee or the Board be open-ended enough to allow for adjustments that are consistent with original intent. Of course, any adjustments would be subject to approval as well.

Benchmarking, Measurement and Reporting

As also mentioned in my last letter, regardless of what plan is agreed upon and implemented, care should be taken that the appropriate benchmarks are set, measurements are in place, and reporting takes place so that those responsible for managing the program will have the data/information they need to understand how the program is progressing in relation to the plan established.

Ongoing Efforts

Given the subject matter(s) we are attempting to cover in this letter and in the upcoming Advisory Committee meeting, I have omitted the usual discussion of ongoing efforts. I expect to re-initiate this discussion in our next letter.

Caveats and Limitations

All caveats and limitations from the 2005 valuation also apply to this letter and any other related analyses, correspondence, etc.

Conclusion

Please feel free to contact me with questions/comments regarding anything presented to date at (317)575-7672 or via e-mail at kvolkmar@uhasinc.com.

Sincerely,

Karl G. Volkmar, FSA, MAAA, FCA
Consulting Actuary

Attachment 1

CalPERS LTC Program Summary of Mitigation Scenarios

Scenario #1

Needed Increase @ 7/1/05:
Less Impact of New Bus:
Less Impact for Clms Mgmt:
Adjusted Increase @ 7/1/05:

Corresponding Adjusted One-Time Increase @ 5/1/07:

32.20% Aggregate Increase Including 3% Margin
3.82% Assuming 2005 Premium Production for 10 Years
4.62% Assuming 2.5% Savings in Future Paid Claims
23.76%
29.60%

Scenario #2

Needed Increase @ 7/1/05:
Less Impact of New Bus:
Less Impact for Clms Mgmt:
Adjusted Increase @ 7/1/05:

Corresponding Adjusted One-Time Increase @ 5/1/07:

32.20% Aggregate Increase Including 3% Margin
7.65% Assuming 2x 2005 Premium Production for 10 Years
4.62% Assuming 2.5% Savings in Future Paid Claims
19.93%
24.80%

Note: Please see Attachment 2 for information regarding rate increases by plan and using various implementation strategies

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Mitigation Scenario Summary - 060605 - KGV Revisions 060704

CalPERS LTC Program
Summary of Sample Rate Adjustment Scenarios
By Product and Implementation Plan

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